UT 96-4
Tax Type: USE TAX
Issue: Machinery and Equipment Exemption - Manufacturing
Disallowed General Deductions

STATE OF ILLINOIS
DEPARTMENT OF REVENUE
OFFICE OF ADMINISTRATIVE HEARINGS
CHICAGO, ILLINOIS

THE DEPARTMENT OF REVENUE)		
OF THE STATE OF ILLINOIS)	Case No.	
	)	IBT No.
v.	)	NTL
	)	
TAXPAYER,	)	Administrative Law Judge
Taxpayer	)	Mary Gilhooly Japlon

RECOMMENDATION FOR DISPOSITION

Appearances: Special Assistant Attorney General Richard A. Rohner, on behalf of the Illinois Department of Revenue; ATTORNEY, on behalf of TAXPAYER.

Synopsis:

This matter comes on for hearing pursuant to the timely protest by TAXPAYER (hereinafter "Armour" or "taxpayer") of Notice of Tax Liability (hereinafter "NTL") No. XXXXX issued by the Department of Revenue (hereinafter "Department") on June 14, 1993 for Use Tax for the period of January 1989 through and inclusive of December 1991.

One of the issues in this case is whether the Use Tax should be imposed on 100 percent of the 3A alcohol purchased by the taxpayer, or solely on that portion consumed in the manufacturing process, the remainder of the alcohol being sold to third parties. Also at issue is the method utilized by the taxpayer to recoup tax amounts it originally self-assessed and paid upon purchase of the 3A alcohol. The parties stipulated to the facts; the Stipulation of Facts is attached hereto and made a part of this recommendation. Testifying at hearing was WITNESS, controller of the corporate taxpayer at the Kankakee facility.

Findings of Fact:

1. The Department's *prima facie* case, inclusive of all jurisdictional elements, was established by the admission into evidence of the Correction of Returns, showing a total liability due and owing in the amount of $134,839 for Use Tax and penalties for the period of January 1989 through December 1991, as well as the Correction of Returns for municipal Service Occupation Tax ("SOT") and penalties for the above-stated period in the amount of $1,700. (Department's Ex. No. 1; Tr. pp. 6, 7).

2. TAXPAYER is a Corporation (F.E.I. #XXXXX, I.B.T. No. XXXXX) with its headquarters at ,). (Joint Ex. No. 1, par. 1; Tr. p. 8).

3. Taxpayer is a manufacturer of Human Plasma derivative Pharmaceutical Products. (Joint Ex. No. 1, par. 2; Tr. p. 8).

4. Taxpayer operates a manufacturing facility located at Route 50 North and Armour Road, Bradley, Illinois. (Joint Ex. No. 1, par. 3; Tr. p. 8).

5. For the period January 1, 1989 to December 31, 1991, the State of Illinois performed a Retailers' Occupation ("sales") and Use Tax audit of taxpayer, culminating with a Notice of Tax Liability, dated June 14, 1993 (Joint Ex. No. 1, par. 4, Ex. A; Tr. p. 8).

6. On August 11, 1993, taxpayer officially protested $91,490 of the alleged tax liability related to recovered 3A alcohol. (Joint Ex. No. 1, par. 5, Ex. B; Tr. p. 8).

7. Taxpayer is not bringing to issue the other protested issue regarding tax on federal excise tax on purchased ethyl alcohol. (Joint Ex. No. 1, par. 5; Tr. p. 8).

8. Taxpayer uses the 3A alcohol in its manufacturing process. (Joint Ex. No. 1, par. 6; Tr. p. 8).

9. During 1989, 39.1 percent of the 3A alcohol was consumed in the manufacturing and recovering process. (Joint Ex. No. 1, par. 6; Tr. p. 8).

10. During 1990, 39.7 percent of the 3A alcohol was so consumed. (Joint Ex. No. 1, par. 6; Tr. p. 8).

11. During 1991, 45.3 percent of the 3A alcohol was so consumed. (Joint Ex. No. 1, par. 6; Tr. p. 8).

12. The remainder of the 3A alcohol for each of the above-stated years was recovered by the taxpayer and sold to third parties. (Joint Ex. No. 1, par. 6; Tr. p. 8).

13. None of the 3A alcohol is retained in the manufactured product. (Joint Ex. No. 1, par. 7; Tr. p. 8).

14. The recovered 3A alcohol, having been in contact with human proteins, cannot safely be reused in the manufacturing process of Human Plasma derivative Pharmaceutical Products. (Joint Ex. No. 1, par. 8; Tr. p. 8).

15. At the time the 3A alcohol was purchased, taxpayer self-assessed and paid Illinois Use Tax on the full purchase price of the 3A alcohol. (Joint Ex. No. 1, par. 9; Tr. p. 8).

16. At the time of resale by taxpayer of the recovered 3A alcohol, taxpayer would offset amounts of self-assessed Use Taxes due to Illinois by an amount equal to the sales tax on the recovered 3A alcohol (based on sales price of the recovered 3A alcohol). (Joint Ex. No. 1, par. 10; Tr. p. 8).

17. The auditor's proposed tax liability of $91,490 is the disallowance of that offset for the tax period in question. (Joint Ex. No. 1, par. 10; Tr. p. 8).

18. The taxpayer purchases human plasma, to which alcohol is added for the purpose of removing various "fractions", or products. (Tr. p. 10).

19. In addition to the alcohol additions, time and temperature are part of the fractionation process. (Tr. p. 10).

20. At the conclusion of this fractionation process, all of the alcohol is removed from the plasma. (Tr. p. 10).

21. A portion of the alcohol is lost during processing. (Tr. p. 10).

22. The alcohol that is not lost is sent to an alcohol recovery system, whereat all of the foreign proteins are removed. (Tr. p. 10).

23. The recovered alcohol, however, cannot be used for human plasma manufacturing, based upon good manufacturing processes within the definitions of the Federal Drug Administration, to which the taxpayer is subject. (Tr. p. 10, 11).

24. The recovered alcohol is either used in the production of non-human products in the taxpayer's facility, or sold to other manufacturers. (Tr. p. 11).

25. When the taxpayer purchases the 3A alcohol, it self-assesses and pays Use Tax. (Tr. p. 12).

26. When the taxpayer sells the recovered alcohol, it deducts the tax amount applicable to the amount sold, and reduces its tax liability by that amount. (Tr. p. 12).

27. The taxpayer credits its tax liability by the amount of tax applied to price of the recovered alcohol actually sold, rather than by the amount the taxpayer consumed. (Tr. p. 13).

Conclusions of Law:

Initially, at issue herein is whether the 3A alcohol that is resold to third parties subsequent to the process of fractioning human plasma is subject to Use Tax. Section 2 of the Use Tax defines "use" in pertinent part as follows:

> "Use" means the exercise by any person of any right or power over tangible personal property incident to the ownership of that property, except that it does not include the sale of such property in any form as tangible personal property in the regular course of business to the extent that such property is not first subjected to a use for which it was purchased, and does not include the use of such property by its owner for demonstration purposes: Provided that the property purchased is deemed to be purchased for the purpose of resale, despite first being used, to the extent to which it is resold as an ingredient of an intentionally produced product or by-product of manufacturing. ... (35 **ILCS** 105/2).

The Use Tax Act provides that various sections of the Retailers' Occupation Tax Act shall apply to the subject matter of the Use Tax Act. (35 **ILCS** 105/12). Among the sections of the ROT Act which apply is 35 **ILCS** 120/4, which states in relevant part the following:

> Section 4. As soon as practicable after the return is filed, the Department shall examine such return and shall, if necessary, correct such return according to its best judgment and information, which return so corrected by the Department shall be prima facie evidence of the correctness of the amount of tax due, as shown therein...
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> Proof of such correction by the Department may be made at any hearing before the Department ... and shall be prima facie proof of the correctness of the amount of tax due, as shown therein.

The taxpayer maintains that the alcohol that is ultimately resold is exempt from the Use Tax Act as an ingredient of an intentionally produced product or by-product of manufacturing. The Department disagrees.

Assuming arguendo that the taxpayer's position is meritorious, and that the recovered alcohol that is resold is not subject to Use Tax, the imminent question is whether the taxpayer can reduce its original tax liability by deducting the amount of sales tax applicable to the amount of recovered alcohol sold. It is interesting to note that as the taxpayer apparently resold the recovered alcohol to third parties, it is unclear whether these third parties were retailers or wholesalers. If they were wholesalers, the taxpayer does not incur a Retailer's Occupation Tax ("ROT") liability. If no ROT liability is incurred, no credit or deduction is appropriate.

Postulating further, however, that the sale to the third parties is a taxable transaction, the sole method for the taxpayer to recover the Use Tax it previously self-assessed and paid is to file a claim for credit. It may not take a deduction on its return in any amount, whether it be the amount of Use Tax already paid, or the amount collected from its customer on the sale of the recovered alcohol. There is no common law right to what amounts to a refund of tax. There is a statutory method for one who bore the burden of the tax to seek a refund; i.e., the claim for credit provisions set forth in section 6 of the ROT Act (35 **ILCS** 120/6). In the case at bar, the taxpayer originally self-assessed and paid the Use Tax to the state. The taxpayer, having borne the burden of the tax, was entitled to file a claim for credit at the time it resold the tangible personal property at issue. To deduct the amount of sales tax attributable to the resales of recovered alcohol is a procedure not contemplated by statute, and therefore, inappropriate and unallowable.

Based upon the stipulated facts, as well as the testimonial evidence adduced at hearing, it is my determination that the law applied thereto necessitates a finding in the Department's favor.

Recommendation:

It is my recommendation that Notice of Tax Liability No. XXXXX be sustained in its entirety.

Enter:

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Administrative Law Judge